CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

April 10, 2000

H.R. 4067
Business Checking Modernization Act

As ordered reported by the House Committee on Banking and Financial Services on March 29, 2000

H.R. 4067 would repeal the prohibition on depository institutions paying interest on the demand deposits of their business customers. The repeal would take effect three years after the date of enactment. In the interim three-year period, H.R. 4067 would in effect authorize depository institutions to offer a new type of savings deposit. It would be allowed up to 24 transfers per month (more if the Federal Reserve allows) into a demand deposit, and it would be subject to reserve requirements. The bill would also provide the Federal Reserve with more flexibility in setting required reserve ratios on transactions accounts by removing the lower limits on the ranges of allowable ratios.

CBO estimates that the bill would have insignificant effects on both federal revenues and outlays. The bill could have the effect of increasing demand deposits at depository institutions, especially after three years when interest could be paid on demand deposits, but based on information provided by staff of the Board of Governors of the Federal Reserve System, CBO estimates that such an effect would not be significant. If the bill did have a significant effect on demand deposits, that could cause a significant increase in required reserves on deposit at the Federal Reserve, which would invest the reserves and remit the return to the Treasury as governmental receipts.

Allowing banks to pay interest on commercial checking accounts could reduce the profitability of some depository institutions. However, certain institutions may be able to retain deposits that would otherwise flow to other providers of financial services. Even if reduced profitability of some institutions did occur because they faced higher interest costs, their business depositors would earn greater profits. Overall profits and federal revenue, therefore, would not be affected.

Based on information from the Federal Deposit Insurance Corporation, CBO estimates that the bill would have no significant impact on the total balance of insured deposits or the likelihood that some institutions would fail and, therefore, no significant impact on federal spending.

Over the three-year interim period, the bill would have an insignificant effect on demand deposits because the new accounts would have limited appeal. Many depository institutions currently utilize sweep programs that regularly transfer amounts between savings accounts not subject to reserve requirements and demand deposits in order to minimize amounts in the non-interest-bearing, demand deposits of businesses that are subject to reserve requirements. Where depository institutions do not provide sweep accounts, many businesses achieve the same effect through their own cash management programs. Since the new accounts would be subject to reserve requirements, they would likely pay a lower yield than the instruments utilized by sweep or cash management accounts.

The effect of allowing interest on business demand deposits would also be limited for the same reason. The interest earned on demand deposits would be less than that available on alternative instruments, which would be nearly as liquid. Some effect might be possible, especially for firms without sophisticated cash management programs with demand deposits at institutions without sweep programs, who might otherwise move their deposits to nonbank competitors. Such an effect, however, is not expected to cause significant budgetary effects.

CBO estimates no budgetary effect would occur from the provision providing the Federal Reserve with additional flexibility in setting required reserve ratios. The Federal Reserve is not currently limited by one of the two ranges affected, and its staff have indicated that no policy change would be likely to occur as a result of enacting the provision in the current economic environment.

Because H.R. 4067 would affect direct spending or receipts, pay-as-you-go procedures would apply. However, CBO estimates that such effects would be insignificant. H.R. 4067 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would impose no costs on the budgets of state, local, or tribal governments.

The CBO staff contacts for this estimate are Mark Booth (for federal revenues) and Mark Hadley (for federal spending). This estimate was approved by Peter H. Fontaine, Deputy Assistant Director for Budget Analysis, and G. Thomas Woodward, Assistant Director for Tax Analysis.